



Department of Energy

Washington, DC 20585

MAR 24 2004

MEMORANDUM FOR FIELD CHIEF FINANCIAL OFFICERS

FROM:

James T. Campbell
JAMES T. CAMPBELL
ACTING DIRECTOR, OFFICE OF MANAGEMENT, BUDGET
AND EVALUATION/ACTING CHIEF FINANCIAL OFFICER

SUBJECT: Implementing Guidance for Recovery Audit Programs

This memorandum transmits the Department's guidance for implementing Public Law (P.L.) 107-107, "*Defense Authorization Act*" and the Office of Management and Budget (OMB) memorandum M-03-07, "Programs to Identify and Recover Erroneous Payments to Contractors," dated January 16, 2003.

P.L. 107-107 requires agencies that enter into contracts with a total value in excess of \$500 million in a fiscal year to carry out a cost effective program for identifying overpayments to contractors, and for recovering amounts overpaid. OMB memorandum M-03-07 requires agencies to review their contractor payments for errors resulting in overpayments (recovery audit), take action to recover those overpayments, and report the results of these activities to OMB on an annual basis.

The attached DOE Recovery Audit Program, along with its four exhibits, provides guidance to payment offices for implementing recovery audit programs to meet these requirements. Instead of prescribing an entirely new process, the Program stresses significant reliance on our existing Improper Payment Act reporting processes. We anticipate the processes your organizations currently use to identify and report improper payments will satisfy most of the audit requirements, and we expect minimal additional review work and reporting for sites with effective processes. As you should note in the attachment, the initial report to Headquarters on the results of these activities is due July 31, 2004.

The identification and recovery of contractor overpayments is an area of increased focus by OMB, and I appreciate your continued support in meeting these reporting requirements. If you have any questions, please contact John Newell on 301-903-2551. Technical reporting questions should be directed to Ben Chatterson on 301-903-4184.

Attachment



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**U.S. Department of Energy
Recovery Audit Program
March 2004**

Background

Public Law (P.L.) 107-107, "Defense Authorization Act" for fiscal year (FY) 2002 requires agencies that enter into contracts with a total value in excess of \$500 million in a FY to carry out a cost effective program for identifying errors in paying contractors and for recovering amounts overpaid. A required element of such a program is the use of recovery audits and recovery activities. In both fiscal years 2001 and 2002, the U.S. Department of Energy (DOE) entered into new contracts in excess of \$500 million. Accordingly, DOE is required to implement a recovery audit program in accordance with this legislation.

The Office of Management and Budget (OMB) issued guidance to Federal agencies to implement this legislation in its memorandum, "M-03-07, Programs to Identify and Recover Erroneous Payments to Contractors," dated January 16, 2003 (Exhibit 1). As required by the OMB guidance, this document provides details on DOE's implementation of the legislation.

Definitions

Recovery Audit - A review and analysis of the agency's books, supporting documents, and other available information supporting its payments that is specifically designed to identify overpayments to contractors that are due to payment errors. It is not an audit in the traditional sense. Rather it is a control activity designed to assure the integrity of contract payments, and as such, it is a management function and responsibility.

Recovery Activity - Any activity by an executive agency to attempt to recover overpayments identified by a recovery audit.

Payment Sites - Includes the Department's three financial service centers, power marketing administrations, major facilities management contractors, and other cognizant sites. Major facilities management contractors include management and operating, management and integrating, environmental restoration management, and other major cost type contractors. Exhibit 2 provides a complete listing of payment offices included in this definition.

Scope of Recovery Audits

Payment offices should consider all types of payments to contractors, regardless of the type of contract, in designing their recovery audit programs. However, payment offices should target certain types of payments or classes of contracts that have the highest potential for overpayment. Exclusion of classes of contracts or payments from recovery audits requires approval from the Secretary of Energy.

Implementation

Payment offices should perform their recovery audits in conjunction with payment reviews required under the Improper Payment Information Act of 2002, P.L. 107-107, and under Prompt Payment as outlined in 5 CFR 1315. Specific requirements related to performing recovery audit and recovery activities are described below.

Recovery Audits

The same methods used to disclose, monitor, and report erroneous payments under the Improper Payment Information Act of 2002, should be used to detect overpayments under your recovery audits. These methods include post payment audits, statistical sampling reviews, automated payment system controls and reports, and data mining reviews. Exhibit 3 provides guidance for performing statistical sampling and data mining reviews.

Types of Payment Errors

Payment offices should design their recovery audits to identify the most significant/material overpayments to contractors. Examples include, but are not limited to, the following:

- Invoice paid twice
- Two different invoices paid for the same good or service
- Payment for goods or services not received
- Payment made without approval
- Payment made to the wrong payee
- Payment not reduced for cost effective discount
- Payments made in excess of invoice amount or order value

Recovery Activities

Based upon the overpayments discovered during the recovery audit, payment offices will need to conduct follow-up actions to determine how they occurred and will need to develop cost effective solutions to resolve them. OMB indicates that recovery activity shall be carried out by Federal employees. However, major facility management and other cost-type contractors are responsible for recovering their overpayments.

Report on Audit Recoveries – FY 2003 Payments

Payment offices must provide the Office of Program Liaison and Financial Analysis (ME-100) with a report by July 31, 2004, containing the following recovery auditing information for FY 2003 payments:

- A description of the types of contractor payments that were reviewed.
- Identification/description of audit procedures that were employed to identify contractor overpayments (e.g., statistical sampling, data mining, system reports, etc.).
- A description of any internal control weaknesses identified and corrective actions taken or planned. Also identify any overall management improvement programs carried out for this initiative.
- Total cost incurred to implement the recovery audit program. Report costs separately for:
 - a) cost of existing processes relied upon to meet recovery audit requirements (e.g.,

existing erroneous payment review and reporting processes); b) incremental costs incurred to meet the requirements (e.g., additional data mining activities, etc.); and c) costs incurred to pay any independent contractor hired to perform recovery audit services.

- Total amount of actual overpayments identified under the recovery audit program categorized by: a) amounts recovered; b) amounts not recoverable (provide a footnote with key drivers why amounts are not recoverable); and c) amounts pending further resolution or collection.

Please e-mail your reports to: ben.chatterson@hq.doe.gov using the format provided in Exhibit 4. Electronic versions of this guidance and the reporting format are available at: <http://www.efo.doe.gov/progliaison/index.htm>.

Similar overpayment recovery information will be required for FY 2004 and FY 2005 payment activities.

If you have any questions please contact Ben Chatterson at 301-903-4184.

January 16, 2003

M-03-07

MEMORANDUM FOR HEADS OF EXECUTIVE DEPARTMENTS AND AGENCIES
FROM: Mitchell E. Daniels, Jr.
Director

SUBJECT: Programs to Identify and Recover Erroneous Payments to
Contractors

The Administration's Improved Financial Performance initiative, part of the President's Management Agenda, includes an initiative to reduce erroneous payments made by the federal government. Erroneous payments waste taxpayer dollars and divert resources from their intended beneficiaries. The attached guidance provides agencies with a tool that can help recover and, more importantly, prevent erroneous contract payments.

Section 831 of the Defense Authorization Act for Fiscal Year 2002 added a new subchapter to the U.S. Code (31 USC §§3561-3567) that requires agencies that enter into contracts with a total value in excess of \$500,000,000 in a fiscal year to carry out a cost-effective program for identifying errors made in paying contractors and for recovering amounts erroneously paid to the contractors. A required element of such a program is the use of recovery audits and recovery activities.

Federal agencies have tested the use of recovery auditing with success. Congress enacted the government-wide requirement to implement recovery auditing as a result of such testing. Recovery auditing is viewed by Congress and the Administration as a cost-effective way to identify and recover erroneous contract and other payments.

The guidance in the attachment to this memorandum is intended to assist agencies to successfully implement recovery auditing and recovery activity as part of an overall program of effective internal control over contract payments.

Reporting: The statute requires that by December 31, 2004, agencies which are required to undertake a recovery audit program shall provide a report to the Office of Management and Budget (OMB) that shall include the following information for programs conducted under this guidance during FY 2003²:

- A general description and evaluation of the steps taken to carry out a recovery auditing program;
- The total cost of the agency's recovery auditing program. Report separately the costs of the agency's recovery audit program activities (agency salaries and expenses) and contracted recovery audit services (amounts paid and payable to recovery audit contractors);

² At its discretion, an agency can also include information concerning its recovery audit program established pursuant to P.L. 107-107 and conducted prior to FY 2003

- The total amount of payment errors identified under the recovery auditing program, the total amount subsequently deemed not recoverable, the total amount recovered, and the total amount outstanding pending final resolution or collection. Report separate totals from amounts attributable to internal agency activities and to recovery audit contractors;
- A general description and evaluation of any management improvement program carried out pursuant to this memorandum;
- A description of the classes of contracts excluded by the agency head.

A similar report is due December 31, 2005, and 2006, covering the fiscal year ending the preceding September 30.

To the extent that agencies believe the guidance does not clarify questions relating to recovery auditing activities or they have questions about the application of this guidance, they should contact their Resource Management Office at OMB.

Guidance on Implementing a Recovery Audit Program

I. General: Agencies shall have a cost effective program of internal control to prevent, detect, and recover overpayments to contractors resulting from payment errors. A program of internal control may include policies and activities such as prepayment reviews, a requirement that all relevant documents be made available before making payment (e.g., invoice, packing list, receiving report, inspection report, etc.), payment of only original invoices (as opposed to photocopies), and performance of contract audits. For agencies that enter into contracts with a total value of more than \$500,000,000 in a fiscal year, a recovery audit program is a required element of their internal controls over contractor payments.

II. Definitions: For purposes of this guidance:

A. A Contract Audit refers to a post-award examination of the books and records of a Federal contractor that is performed by the contracting officer, or an authorized representative of the contracting officer, pursuant to the audit and records clause incorporated in the contract. A contract audit is normally performed by an auditor that serves in an advisory capacity to the contracting officer. A post-award contract audit, as distinguished from a recovery audit, is normally performed for the purpose of determining if amounts claimed by the contractor are in compliance with the terms of the contract and applicable laws and regulations. For example, the scope of a post-award contract audit may include a review of the direct and indirect costs claimed to have been incurred or anticipated to be incurred under a negotiated contract. Such reviews involve the contractor's accounting records, including the contractor's internal control systems. A post-award contract audit may also include a review of other pertinent contractor records, e.g. reviews to determine if a contractor's proposal was complete, accurate, and current; reviews of contractor prices charged for commercial items sold to other Federal and non-Federal customers; reviews of the contractor's systems established for identifying and returning any erroneous payments received under its Federal contracts.

B. A Recovery Audit Contingency Contract is a contract for recovery audit services in which the recovery audit contractor is paid a portion of the amount recovered. The amount the contractor is paid, generally a percentage of the recoveries, is based on the amount actually collected based on the evidence discovered and reported by the recovery audit contractor to the appropriate agency official.

C. A Management Improvement Program is an agency-wide program to address the flaws in an agency's internal controls over contractor payments discovered during the course of implementing a recovery audit program or other control activities over contractor payments.

D. Payment Errors are errors resulting from duplicate payments; errors on invoices or financing requests; failure to reduce

payments by applicable sales discounts, cash discounts, rebates, or other allowances; payments for items not received; mathematical or other errors in determining payment amounts and executing payments; and the failure to obtain credit for returned merchandise.

E. Recovery Activity is any activity by an executive agency to attempt to recover overpayments identified by a recovery audit.

F. A Recovery Audit is a review and analysis of the agency's books, supporting documents, and other available information supporting its payments that is specifically designed to identify overpayments to contractors that are due to payment errors. It is not an audit in the traditional sense. Rather it is a control activity designed to assure the integrity of contract payments, and as such, it is a management function and responsibility.

G. A Recovery Audit Program is an agency's overall plan for the performance of recovery audits and recovery activities. The head of the agency will determine the manner and combination of recovery audits and activities that are expected to yield the most cost-effective recovery audit program for the agency. This program should include a management improvement program as defined above and discussed in Section IX.

III. Scope of Recovery Audits

A. All classes of contracts and contract payments should be considered for recovery audits. Agencies should review their different types of contracting categories and identify those classes of contracts that have a higher potential for payment errors, i.e., contract categories where the benefits would likely exceed the agency's costs of the recovery audits and recovery activities.

B. Agency heads may exclude classes of contracts and contract payments from recovery audit activities if the agency head determines that recovery audits are inappropriate or are not a cost-effective method for identifying and recovering erroneous payments. The following are examples of classes of contracts and contract payments that may be so excluded:

1. Cost-type contracts that have not been completed where payments are interim, provisional, or otherwise subject to further adjustment by the Government in accordance with the terms and conditions of the contract.
2. Cost-type contracts that were completed, subjected to a final contract audit and, prior to final payment of the contractor's final voucher, all prior interim payments made under the contract were accounted for and reconciled.
3. Other contracts that provide for contract financing payments or other payments that are interim, provisional, or otherwise subject to further adjustment by the Government in accordance with the terms and conditions of the contract.

4. Recent payments may be excluded for a reasonable period of time in order to allow the agency's normal post-payment processes to identify and correct any overpayments.

C. Recovery auditing contractors may, with the consent of the employing agency, communicate with the agency's contractors for the purpose of verifying the validity of potential payment errors they have identified. A recovery auditing contractor shall not maintain a presence on the property of the contractors that are the subject of recovery auditing.

D. Agency heads shall take steps to ensure that the implementation of their recovery audit program does not result in duplicative audits of contractor records. In this regard, actions to follow-up with contractors on potential overpayments identified through recovery audits of agency records do not constitute audits of contractor records. However, recovery auditing activities should not duplicate other audits of the same (contractor or agency) records that specifically employ recovery audit techniques to identify and recover payment errors. At a minimum, agency heads should coordinate with the agency Inspector General and other organizations with audit jurisdiction over agency contracts.

E. In addition to identifying and documenting specific overpayments resulting from payment errors, recovery auditors should also analyze the reasons why payment errors occurred and, where appropriate, recommend cost-effective controls to prevent such overpayments in the future. The results of such analysis and related recommendations should be considered by the agency as part of its management improvement program. If requested, the agency should provide such information to its Office of Inspector General.

F. Instances of potential fraud discovered through recovery audits and recovery activities shall be reported immediately to the agency Inspector General.

IV. Sources of Recovery Audits: Recovery audits may be performed by employees of the executive agency, by any other department or agency of the United States Government acting on behalf of the executive agency, or by contractors performing recovery audit services under contracts awarded by the executive agency.

V. Role and Authority of Inspectors General

A. Nothing in this guidance should be construed to impair the authority of an Inspector General under the Inspector General Act of 1978 or any other law. However, because the recovery audit program required by this guidance is an integral part of the agency's internal control over contract payments, and therefore a management function, independence considerations would normally preclude the Inspector General and other agency external auditors from carrying out management's recovery audit program.

B. Agency Inspectors General and other external agency auditors are encouraged to assess the effectiveness of agencies' recovery

audit programs as part of their internal control work on existing audits, e.g., the annual financial statement audit, or as a separate audit.

VI. Recovery Audit Services Performed by Contractors

A. Agency heads may enter into any appropriate type of contract, including a contingency contract for recovery audit services. However, amounts recovered due to interim payment errors made under ongoing contracts, i.e., duplicate progress payments or cost reimbursement claims, may not be available to pay the recovery audit fee if these amounts are still needed to make subsequent payments under the contract. Agencies need to establish other funding arrangements when making payments to recovery audit contractors in such cases.

B. In addition to provisions that describe the scope of recovery audits (and any other provisions required by law, regulation, or agency policy), any contract with a private sector firm for recovery audit services shall include contract provisions that:

1. Prohibit the recovery audit contractor from:

a. requiring production of any records or information by the agency's contractors. Only duly authorized employees of the agency can compel the production of information or records from the agency's contractors, in accordance with applicable contract terms and agency regulations;

b. establishing or otherwise having a physical presence on the property or premises of any other agency contractor for the purpose of performing the contract;

c. acting as an agent for the Federal Government in the recovery of funds erroneously paid to contractors;

d. using or sharing sensitive financial information with any individual or organization, whether associated with the Federal Government or not, that has not been released for use by the general public, except for the purpose of fulfilling the recovery audit contract; and

e. disclosing any information that identifies an individual, or reasonably can be used to identify an individual, for any purpose other than performing the recovery audit.

2. Require the recovery audit contractor to take steps to safeguard the confidentiality of sensitive financial information that has not been released for use by the general public and any information that could be used to identify a person.

VII. Recovery Activity - Recovery activity shall be carried out by Federal employees. Agencies shall follow applicable laws and regulations governing collection of amounts owed to the Federal Government.

VIII. Disposition of Recovered Amounts

A. Funds collected under a recovery audit program less any amounts needed to make payments under the related contract(s) shall be available to the executive agency for the following purposes:

1. To reimburse the actual expenses incurred by the executive agency for the administration of the program (including payments made to other agencies that carry out recovery audit services on behalf of the executive agency).
2. To pay contractors for recovery audit services.

B. Except as provided in paragraph C., any amounts erroneously paid by an executive agency that are recovered under a recovery audit program that are not used to reimburse expenses of the executive agency or pay recovery audit contractors under paragraph A:

1. Shall be credited to the appropriations from which the erroneous payments were made, shall be merged with other amounts in those appropriations, and shall be available for the purposes and period for which such appropriations are available; or

2. if no such appropriations remain available, shall be deposited in the Treasury as miscellaneous receipts.

C. When required or authorized by other provisions of law, any funds remaining after reimbursing expenses of the executive agency and paying recovery audit contractors, shall be credited to a non-appropriated fund instrumentality, revolving fund, working-capital fund, trust fund, or other fund or account.

D. Contingent fee contracts shall preclude any payment to the recovery contractor until the recoveries are actually collected by the agency.

E. All funds collected and all direct expenses incurred as part of the recovery audit program shall be accounted for specifically. The identity of all funds recovered shall be maintained as necessary to facilitate the crediting of recovered funds to the correct appropriations and identify applicable time limitations associated with the appropriated funds recovered.

IX. Management Improvement Programs

Section 3564 of title 31, U.S. Code, also authorizes agencies to implement "management improvement programs." Such programs shall take the information gleaned from the recovery audit program, as well as other audits, reviews, or information that identify weaknesses in an agency's internal controls, and ensure that actions are undertaken to improve the agency's internal controls governing contract payments.

X. Grant Programs - Agencies whose grant programs fund significant contract activity by grant recipients may consider including contracts at the grant recipient level in their recovery audit program. Agencies can engage contractors on a contingency basis to the extent otherwise authorized by law.

PAYMENT SITES AND ASSIGNED FIELD SITES SUBJECT TO AUDIT RECOVERY REQUIREMENTS

REPORTING OFFICE	PAYMENT OFFICE
Bonneville Power Marketing Administrations Capital Accounting Center	Bonneville Power Marketing Administration Capitol Accounting Center reports Federal payments for: Headquarters, Pittsburgh, Schenectady, Chicago, Elk Hills, Casper, Grand Junction – Legacy Management
Chicago Operations Office	Ames laboratory Argonne National Laboratory Brookhaven National Laboratory Fermi National Laboratory Princeton Plasma Physics Laboratory
Federal Energy Regulatory Commission Idaho Operations Office	Federal Energy Regulatory Commission Idaho National Engineering & Environmental Laboratory
NNSA SERVICE CENTER	Albuquerque Payment Center reports Federal payments for: Albuquerque, Golden, Nevada, Oakland, Idaho Los Alamos National Laboratory Kansas City Plant National Renewable Energy Laboratory Pantex Plant Sandia National Laboratory Nevada Test Site Lawrence Livermore National Laboratory Lawrence Berkley National Laboratory Stanford Linear Accelerator
Oak Ridge Operations Office	Oak Ridge Associated Universities Y-12 Oak Ridge National Laboratory Oak Ridge Environmental Management Environment Facility
Oak Ridge Payment Center	Oak Ridge Payment Center reports Federal Payments for: Oak Ridge Operations Office, the Office of Scientific and Technical Information, Ohio Field Office, Strategic Petroleum Reserve, Rocky Flats, Richland, Savannah River Operations Office, and National Energy Technology Laboratory.
Ohio Field Office	Fernald Environmental Management Project Mound West Valley Nuclear Services Company
Pittsburgh Naval Reactors Richland Operations Office	Bettis Atomic Power Laboratory Bechtel-Hanford Fluor-Hanford CH2 Hanford Pacific Northwest National Laboratory
Rocky Flats Savannah River Operations Office	Rocky Flats/Kaiser Savannah River Plant Waste Isolation Plant
Schenectady Naval Reactors	Lockheed Martin-KAPL, Inc.

REPORTING OFFICE	PAYMENT OFFICE
Southeastern Area Power Marketing Administration	Southeastern Area Power Marketing Administration
Southwestern Area Power Marketing Administration	Southwestern Area Power Marketing Administration
Strategic Petroleum Reserve	Strategic Petroleum Reserve- McDermott
Western Area Power Marketing Administration	Western Area Power Marketing Administration

* **Reporting Office** is the site that is physically transmitting the data to HQ.

** **Payment Office** is the site whose erroneous payment data is being submitted.

Statistical Sampling and Data Mining

Statistical Sampling

Statistical sampling entails selecting a sample of vendor/contractor payment transactions, obtaining documentation (i.e., vendor invoices, contract documentation, and receiving reports) to support the payments, and analyzing the supporting documentation to ascertain the propriety of payments.

Payment offices should consider consulting with a statistician or other authority in designing their samples where necessary. The sample should be randomly selected and of sufficient sample size to provide a 90 percent confidence level, with a precision rate of plus or minus 10 percent.

If overpayments are identified through the statistical sampling review, offices are required to ascertain how they occurred and are responsible for developing cost effective solutions to resolve them.

Data Mining

Data mining involves examining payment data for certain anomalies which may reveal overpayments to contractors such as duplicate invoice payments or missed discounts. Payment data may be queried from system databases or tables, data warehouses or from a database created for the sole purpose of data mining. Existing payment system query software or software such as Microsoft Access and ACL may be used to perform data mining/interrogation. Queries similar to the following may be performed to identify anomalies with the payment data:

Suggested Queries for Data Mining

1. Were there any instances of multiple payments under the same contract/purchase order on the same day?
Query: Find instances where one contract/purchase order number has multiple payments on the same day. Provide details with associated invoice numbers paid.
2. Were there instances of an invoice number being paid more than once?
Query: Find instances where identical or similar invoice numbers with an extension, (e.g., match an invoice with a number 12345 with one with the number 12345A.)
3. Were payments made to the same vendor more than once a day?
Query: Match instances where individual vendors have more than one payment with the same payment date. Provide details with associated contract/purchase order numbers and invoice numbers paid.
4. Do any of the vendors have the same address?
Query: Find instances where vendors with different names or DUNS numbers have the same mailing address.
5. Do any vendors have more than one payment address for a single contract/purchase order number?

Query: Find vendors with multiple mailing addresses under a single contract/purchase order number.

6. Were there any payments made for the same amount during a 30-day period?
Query: Find instances where the amount of the payment is the same during a 30-day period. Sort instances of same payment amounts by date of payment and provide vendor identification detail.
7. Were there any credits? How much? How frequently to the same vendor?
Query: Provide a list of any negative payments or negative invoice amounts.
8. Were there any payments made in excess of the approved invoice amount?
Query: Find instances where the payment amount exceeded the approved invoice amount.
9. Were there any payments made where a discount was offered but not taken?
Query: Provide instances where a vendor offered a discount (a cost effective discount), but the amount of the discount was zero.
10. Were there any instances where cumulative payments or cumulative costs exceed cumulative obligations under a contract/purchase order?
Query: Find instances where cumulative obligations are less than cumulative payments or cumulative costs.
11. Were there any instances where cumulative payments or cumulative costs are negative under a contract/purchase order?
Query: Find instances where cumulative payments or cumulative costs are less than zero.

FISCAL YEAR 2003 REPORT ON RECOVERY AUDIT ACTIVITIES (For <Reporting Site Name>)

PART 1: CONTRACTOR PAYMENT TYPES	
DESCRIPTION OF CONTRACTOR PAYMENT TYPES REVIEWED	

PART 2: AUDIT PROCEDURES

	YES* (X)	NO (X)
STATISTICAL SAMPLING		
DATA MINING		
IDENTIFIED BY SYSTEMS		
OTHER (SEE NOTE)		
NOTES:		

* Provide a brief description of process.

PART 3: INTERNAL CONTROL AND OTHER	
BRIEF DESCRIPTION OF INTERNAL CONTROL WEAKNESSES IDENTIFIED	

FISCAL YEAR 2003 REPORT ON RECOVERY AUDIT ACTIVITIES (For <Reporting Site Name>)

ACTIONS TAKEN TO CORRECT CONTROL DEFICIENCY	
OTHER MANAGEMENT IMPROVEMENT INITIATIVES	

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